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August 17, 2004

Mary L. Cottrell, Secretary  
Department of Telecommunications & Energy  
Commonwealth of Massachusetts  
One South Station, 2<sup>nd</sup> Floor  
Boston, Massachusetts 02110

**Re: D.P.U./D.T.E. 97-88/18 – PAYPHONE SERVICES**

Dear Ms. Cottrell:

Verizon Massachusetts (“Verizon MA”) hereby responds to comments filed by the Attorney General (“AG”) on August 9, 2004, regarding Verizon MA’s July 22, 2004, compliance filing in the above proceeding. As explained below, there is no reasonable basis to suspend and investigate Verizon MA’s filing, as the Attorney General suggests. Verizon MA’s filing fully complies with the Department’s orders in both this case and D.T.E. 01-31 regarding the re-pricing of payphone services and the resultant increase in the residential dial tone-line rate. Accordingly, the Department should reject the Attorney General’s claims and approve the proposed rate changes contained in that filing for effect October 6, 2004.

### **ARGUMENT**

The Attorney General requests that the Department bifurcate this investigation to consider the “exogenous adjustment recovery” on a separate track not subject to the October 6, 2004 implementation date for the payphone rate reductions. According to the Attorney General, such an approach is warranted because the Department will need to develop a detailed record on various issues. Specifically, the Attorney General contends: (1) Verizon MA’s proposal to recover the revenue loss associated with the payphone rate reductions must be thoroughly reviewed to determine whether it qualifies as an exogenous adjustment under the company’s Alternative Regulation Plan; (2) the Department must verify that Verizon MA has accurately quantified the revenue loss from the payphone rate reductions; (3) the Department must examine why Verizon MA did not

apply the rate increase to all residential dial tone lines; and (4) the Department should allow the Attorney General to determine whether there are “negative exogenous cost adjustments that could the [sic] reduce dial tone rate.” AG Comments at 3-4. The Attorney General’s claims are without merit and provide no cause for the Department to bifurcate this proceeding and undertake the investigation he recommends.

*First*, contrary to the Attorney General’s suggestion, there is no need for the Department to open an investigation regarding Verizon MA’s right to a revenue-neutral offset of the payphone rate reductions. There cannot be any serious debate on this point because the Department has already decided the issue. Verizon MA’s proposal here only implements conclusions reached by the Department in D.T.E. 01-31 relating to revenue-neutral rate changes for wholesale switched access services and for wholesale-like services, such as Public Access Line (“PAL”), Public Access Smart-Pay Line (“PASL”), and collocation.<sup>1</sup>

In its *Phase I Order* in D.T.E. 01-31, the Department directed that Verizon MA come forward in its Phase II filing with proposals to lower switched access rates to more economically efficient levels and to reprice all wholesale-like services “in a UNE-based manner.” *Phase I Order* at 95. Verizon MA made its Phase I compliance filing on June 5, 2002, proposing, per the Department’s directive, access reductions, payphone rate changes, and collocation rate changes. *See* D.T.E. 01-31 (Phase I) June 5, 2002, Compliance Filing, at Tab B, Att. I, Workpaper 1. Verizon MA calculated the revenue effect of these rate changes, and proposed offsetting the resulting negative revenue effect through increases in residence rates. *Id.*

The Department’s *Phase II Order* in D.T.E. 01-31 adopted Verizon MA’s proposal to make revenue-neutral offsets to residence rates associated with the rate changes for switched access and wholesale-like services. The Department recognized the “concept of ‘revenue-neutral’ price changes between wholesale and retail services (*Phase II Order* at 93-94) and ruled that “it is appropriate and fair that movement on one side of the ledger be matched with symmetrical movement on the other side.” *Id.* at 94. In short, the Department expressly addressed in the *Phase II Order* whether the rate changes for wholesale and wholesale-like services should be revenue-neutral to the company and concluded that they should.

Consistent with that determination, the Department approved Verizon MA’s Phase II rate proposals for switched access charges and collocation and implemented revenue-neutral offsets to residence rates associated with those price changes. *Phase II Order* at 43, 92-94. With respect to PAL and PASL services, although the Department

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<sup>1</sup> The collocation services that the Department considered to be wholesale-like were not the collocation arrangements Verizon MA makes available to CLECs under the Telecommunications Act of 1996. Rather, the services pre-date the 1996 and were available to both carriers and end-user customers.

found that Verizon MA had submitted a pricing proposal that complied with the *Phase I Order*, it chose not to set the rates in D.T.E. 01-31. Instead, the Department deferred action on the specific rate levels for PAL and PASL services to the pending payphone proceeding. *Id.* at 42-43. However, this action only deferred the quantification of the revenue effect associated with PAL and PASL rate changes until the Department set the prices; it did not change the underlying ruling in the *Phase II Order* that rate changes, if any, for these wholesale-like services would be revenue neutral. Indeed, nothing in the *Phase II Order* suggests that the repricing of PAL and PASL services was to be treated any differently in terms of revenue neutrality from the repricing of other wholesale and wholesale-like services, whose revenue effect could be quantified in D.T.E. 01-31. The only difference was that the rates for PAL and PASL services would be determined later.

*Second*, the Attorney General's claim that further investigation is necessary to enable him to quantify the revenue effect of the PAL and PASL rate reductions is without merit. Computing the revenue effect of the reductions is a simple, straight-forward analysis. As shown in its compliance filing, Verizon MA calculated the revenue shortfall using current TELRIC-based rates determined in D.T.E. 01-20 and May 2004 payphone line quantities. *See* D.P.U./D.T.E. 97-88/18 Compliance Filing of July 22, 2004, at Att. I, Workpaper 2. In addition, Verizon MA used payphone-specific distributions based on density zones (*i.e.*, Metro, Urban, Suburban and Rural) from D.T.E. 01-20. *Id.* at Workpaper 3. The methodology used by Verizon MA is no different than the methodology used to calculate the revenue effects of the price changes for switched access and collocation approved in D.T.E. 01-31. That is, the company applied the approved rates to current quantities of the services being repriced. The PAL and PASL analysis demonstrates an annual revenue loss to Verizon MA of \$4.36 million.

The Attorney General's contention that Verizon MA's filing relied on "stale data" to quantify the revenue effect is simply wrong. AG Comments at 3. Indeed, the only figure that the Attorney General points to in support of that claim is one component of the calculation used to compute the local usage rate of \$0.002. For that computation, it is necessary to weight interoffice and intraoffice usage. As the Attorney General notes, Verizon MA used a 46%/54% split for this weighting based on Verizon MA's September 2001 testimony. *Id.* at fn. 7. However, even if that split were to vary, it would have a minimal effect on Verizon MA's projected annual revenue loss because the rate range for interoffice versus intraoffice usage is narrow (*i.e.*, \$0.002693 versus \$0.001549 per minute). D.P.U./D.T.E. 97-88/18 Compliance Filing of July 22, 2004, at Att. II, Workpaper 3.

*Third*, the Attorney General claims that further investigation is necessary to examine Verizon MA's proposal to implement the offset on *basic* residential dial tone lines, rather than increasing all residential exchange services. AG Comments at 3. He asserts that if the offset were applied to all residence lines the resulting increase would be \$0.16 per line, instead of the \$0.34 proposed by the company. His position is without merit.

To offset the \$4.36 million payphone revenue reduction, Verizon MA proposes to increase the Dial-Tone Line (“DTL”) rate element for basic residence services (1FR, 2FR, and 1MR), Metropolitan Service, Suburban Calling Service, and Circle Calling Service.<sup>2</sup> See D.P.U./D.T.E. 97-88/18 Compliance Filing of July 22, 2004, at Att. II, Workpaper 2. Verizon MA also applies that rate increase to the DTL rate component of the following residential services: Eastern LATA Unlimited Calling Plan; Call Around 413 Plus; and Baystate East (Metropolitan and Non-Metropolitan). The compliance filing does not, however, apply any rate increase to newly introduced packaged residential services, *i.e.*, Freedom and Freedom Extra, Local Package and Local Package Extra, Regional Package and Regional Package Extra, and Local and Toll Package (SoundDeal).<sup>3</sup> See *id.*, at Att. II, Workpaper 2. The exclusion of the packaged offerings from the offset is consistent with Department policies and the pricing flexibility afforded the company under the Alternative Regulation Plan.

The Department has repeatedly found that it looks to principles of competitive pricing to assess whether rates for individual services are just and reasonable and to achieve its goal of economic efficiency. *Phase II Order* at 73, 79; D.P.U. 94-50, *Order* at 113 (1995); D.P.U. 1731, *Order* at 19-25 (1985). Specifically, the Department has concluded that “efficient market prices in competitive markets for telephone services are based on incremental costs plus a mark-up for joint and common costs pursuant to Ramsey pricing principles, where joint and common costs are recovered in inverse proportion to the demand elasticity of particular services.” *Phase II Order* at 73. The Department’s recognition that “the demand for basic residential service is very inelastic, and likely very close to zero” (*id.*, at 74) was the basis for its decision in D.T.E. 01-31 to increase the residence DTL rate by \$2.44 to achieve revenue neutrality with the price changes for switched access services and wholesale-like services. *Id.* at 80-81. Verizon MA’s proposal here is in line with that policy. The DTL for the basic services that are subject to the increase are the least elastic of Verizon MA’s offerings, and even with that modest increase, their relative contribution to the recovery of joint and common costs will still be significantly below other services.

By contrast, the packaged offerings excluded from the increase are extremely competitive and thus less elastic than other residence services. It was for this very reason that the Department granted the company market-based pricing flexibility over non-basic residence services in the Alternative Regulation Plan. *Id.* at 85-86; see also Alternative Regulation Plan, at Tab A, Att. A & B (June 6, 2003). Requiring that Verizon MA now increase the prices for packaged services – which were developed to meet comparable

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<sup>2</sup> The total number of residence lines subject to the rate increase is approximately 1,067,900 (excluding Lifeline subscribers). See D.P.U./D.T.E. 97-88/18 Compliance Filing of July 22, 2004, at Att. II, Workpaper 1.

<sup>3</sup> These packaged offerings account for approximately 1,026,208 million residence lines in Massachusetts.

offerings of competing carriers – places the company at a competitive disadvantage and undercuts the Department’s decision to have the prices for these services set on the basis of market forces. In his comments, the Attorney General provides no basis for the Department to retreat from its policy of adjusting rates on the basis of Ramsey principles and classifying the packaged offerings as competitive, thereby warranting full pricing flexibility.

*Fourth*, the Attorney General asserts that further investigation is necessary because there may be exogenous cost changes – such as federal tax changes – that could ameliorate the impact of the PAL/PASL rate changes. AG Comments at 4. The Department’s Alternative Regulation Plan permits the Attorney General to file a petition to account for such changes, if there are any. However, he has not done so. Verizon MA’s filing in this case should not be held hostage to mere unsubstantiated allegations that such exogenous cost changes exist.

*Finally*, even if the Department determines that a further examination of Verizon MA’s offset proposal is warranted, it should not bifurcate the case as suggested by the Attorney General but should proceed expeditiously to ensure that the PAL and PASL rate reductions are implemented coincident with revenue-neutral rate changes in other services. Reducing payphone rates without a corresponding increase in retail rates would shortchange Verizon MA by forcing the company to absorb a revenue loss. This is not only unfair but contradicts the Department’s finding in D.T.E. 01-31 that “it is appropriate and fair that movement on one side of the ledger be matched with symmetrical movement on the other side.” *Phase II Order* at 94. As recognized by the Department, these pricing changes are inextricably linked and must be implemented simultaneously on a revenue-neutral basis. Thus, although the investigation suggested by the Attorney General is unnecessary, the Department should not divorce the timing of the PAL/PASL rate decreases from the offsetting rate increases that are necessary to keep Verizon MA whole.

## **CONCLUSION**

In conclusion, the Department should reject the Attorney General’s claims and approve Verizon MA’s proposed rate changes for payphone and basic residence lines. There is no need to conduct an investigation of such rate changes because, as described above, they are in full compliance with the Department’s directives in this case and D.T.E. 01-31. In addition, the Department should not bifurcate Verizon MA’s rate proposal, as the Attorney General suggests. This is unwarranted and would contravene

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the Department's long-standing policy of rate rebalancing to ensure revenue neutrality in the re-pricing of wholesale and retail rates.

Very truly yours,

/s/Barbara Anne Sousa

Barbara Anne Sousa

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